$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

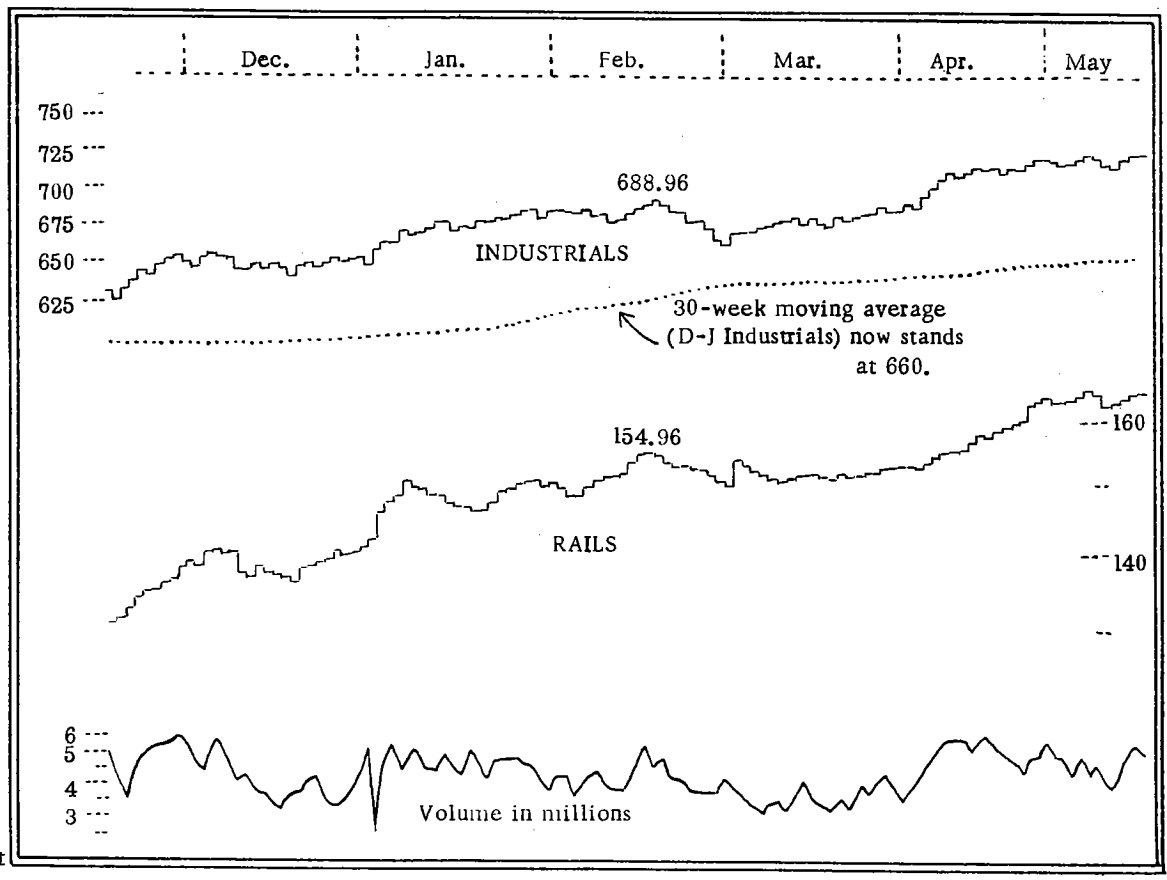
Registered with the Securities and Exchange Commission

THE MARKET Near-term: Letter 216 commented: "If stocks move up on heavy volume, then settle back grudgingly on reduced volume, the implications are bullish." So far, this would seem to describe much of the action which is taking place today. Until this pattern changes, the short-term direction of the market must be considered up.

Longer Term: Many market students are still wondering whether a bull market started (or resumed) on June 26, 1962, or whether we are witnessing one of the trickiest secondary (upward) corrections on record. Sceptics have not forgotten Hamilton's observation that secondaries "...can look deceptively like the real thing." Nor have they forgotten Rhea's description of the 1930 correction: "Nearly everyone was proclaiming a new bull market. Services were extremely bullish, and the upside volume was running higher than at the peak in 1929."

As to secondaries in general, Rhea noted: "When a secondary is in the making the question is often asked, 'How far will it go?' Under the implications of the Averages, one is reasonably safe in saying that important secondaries generally retrace from one-third to two-thirds or more of the ground lost since the termination of the last major interruption of the market. This generalization can be tremendously useful, but those who try to place exact limits on secondary reactions are doomed to failure just as surely as would be the weatherman who forecasted a snowfall of exactly three and one-half inches within a specified time."

Again Rhea commented: "If we could say that the great majority of secondaries terminated around the 50% recovery point, speculation would be easy. Unfortunately, careful analysis shows that 7% of all reactions terminate after retracing between 10 to 25%, 25% terminate after retracing 25 to 40%, 18% terminate after retracing 40 to 55%, 27% after retracing 55 to 70%, 8% after retracing 70 to 85%, with 14% of all secondary movements extending beyond 85% retracement."



As of this writing, the Rail Average has risen within 9 points of its 1959 high of 173.56 (it has bettered its 1960 peak of 160.43). Industrials are now within striking distance of their all-time high of 734.91. If the rise since June, 1962, was indeed part of a true primary bull movement, then it should merely be a matter of time before Industrials hurdle the 734.91 level and Rails better their 1959 high.

But a Dow Theorist might insist: "If this is a new bull market (not a

continuation of the bull market which began in 1949), then all previous highs are meaningless, since one bull market has no relationship to any other bull market."

This argument has considerable merit, but of the two possible bull views, namely : (1) this is a brand new bull market, and (2) this is a continuation of the 1949 bull market, I would settle for the latter, assuming that the Averages go through their highs. The reason is that I have always believed that Dow's Theory entails more than a mere mechanical reading of the Averages. At the 1962 lows, none of the classic characteristics of a major bull market base were present, and I, personally, would find it easier to accept the thesis that the 1962 "crash" was an unprecedented interruption in an unprecedented bull market than I would that a new bull market began in June, 1962.

As far as this writer is concerned, the final proof lies ahead. If Rails and Industrials stubbornly refuse to better their respective 1959-61 peaks, then the whole movement will go down in history as "another 1930" (and in many ways, even more deceptive). On the other hand, if the two indicators put all previous highs behind them, then we will undoubtedly be in for some unusual times. The following section deals in part with such a contingency.

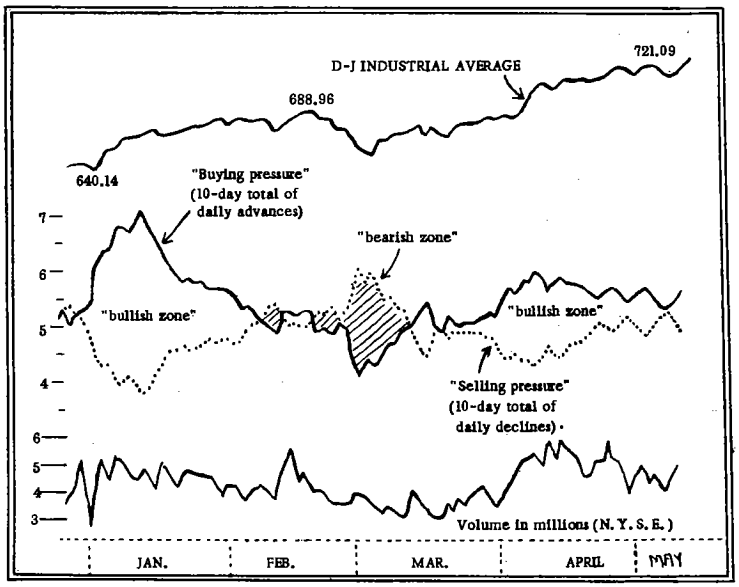
BIG ONE STILL TO COME? A handful of analysts have remained steadfastly bullish on the stock market since 1949. They have felt that the whole era "ought to end" with something approximating or surpassing the speculative fury of 1928-29. Personally, I have been of the opinion that the period since 1959 has contained enough in the way of speculation and speculative excesses to qualify as a "New Era" top. Average stock yields have receded to the 3% zone of overvaluation, low-priced stocks have skyrocketed, the public has entered (and exited), a genuine "new issue" market has prevailed, foreign stocks have had their following, boardrooms have had their "standing room only" signs, price earnings ratios have risen to "absurd" heights, fad after fad has lured the public into paying high prices for issues and groups which have subsequently collapsed.

Nevertheless, it is true that there were perhaps 2 to 3 million people in the stock market in 1928-29 as against perhaps 18 million people today. Considering this fact, a few analysts have maintained that a true New Era peak for the great bull market of the '50's should have been accompanied by massive speculation, unprecedented public hysteria and daily volume in perhaps the 8 to 10 million share-per-day class. Furthermore, many of these sceptics insist that the top should have been accompanied by exhaustion of bank credit, a situation which did not occur at any time during the late '50's or early '60's.

Supporting the idea that the best is yet to come, these analysts have drawn attention to the recent seeming immunity of the public to recurrent crises. Cuba, Haiti, Laos, Viet Nam -- nothing seems to arouse any great interest from the crowd any more. It is as if the average person is saying: "Look, I've been shaken up too many times in the last five years. I'm numb. Don't tell me what's happening, don't worry me with nuclear destruction, don't warn me about the end of the world. Just give me the good life on the 'no-down-payment plan' and a vacation once a year in a sunny climate. It can't be done? Listen, I'm doing it -- and if things get too rough I'll just consolidate all my debts into one huge, impossible payment-plan. I'm no puritan, and I'm no ascetic. My Government is spending like there's no tomorrow; am I better than the Government?"

And so it goes; the public is still spending, the "crash" is almost a year behind us, six million short-sellers are saying that stocks are too high (but stocks don't go down), and the bear case has yet to be proved. Is this all a subtle pattern preparatory to a final explosive boom, a boom that will dwarf anything so far seen?

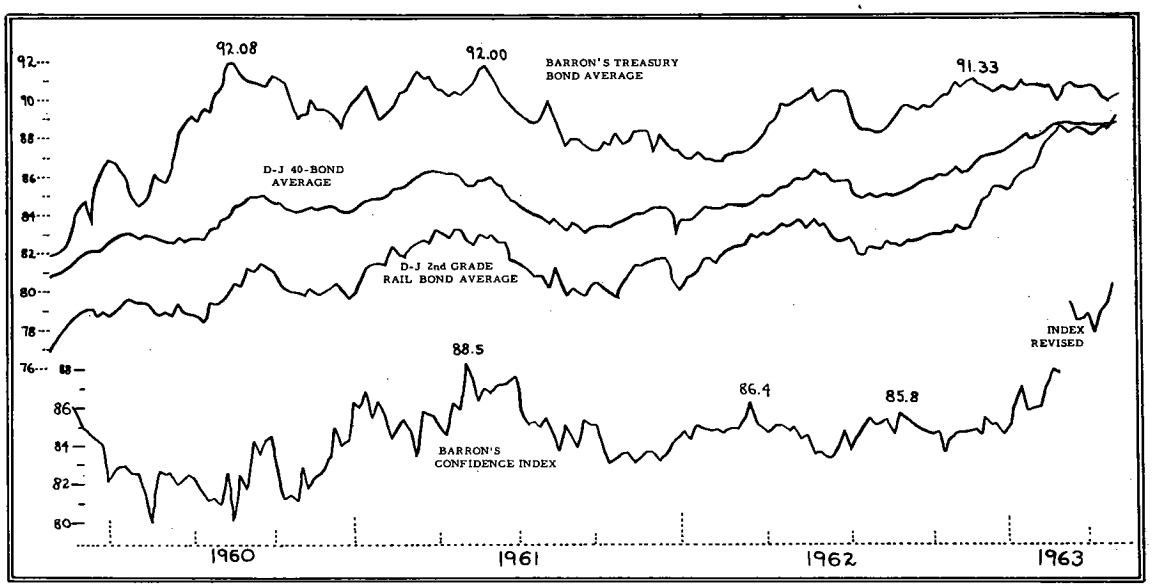
A monetary expert once said: "All currency was made to be devalued." More and more I hear this argument put forth by those who are buying stocks. "How can the Government continue to spend this way without destroying the dollar?" I am asked. Others point out that for the first time in our history we now have a President and an Administration who not only refuse to apologize for the prospect of an unbalanced budget -- they actually advocate an unbalanced budget as an instrument of official policy.



BUYING AND SELLING PRESSURE On May 7 the buying pressure line came within a fraction of touching the selling line (see chart). This was followed by a sudden burst of strength in the market, and on May 8 and 9 the buying line again rose while the selling line declined.

The buying line has now held above the selling line for 38 days, and buying pressure is beginning to approximate (from a timing standpoint) the sort of action usually

associated with an upside "power move". As mentioned before, the two lines usually cross and recross every 15 to 30 days. On those few occasions when one line holds above the other for an abnormally long time, the stage is set for the development of an extraordinary move.



If buying pressure now zig-zags above its previous peaks while selling pressure drops below its own previous decline lows, I would think that we were in for a rise of surprising proportions. I should be remembered, however, that the recent trend of the two lines has been toward a crossing (selling pressure about buying). An upward zig-zag in the buying line and a downward zig-zag in the selling line would reverse this trend, and this is the phenomenon to watch for in the next week or so.

RISING BONDS Periodically, these letters have offered comments on the bond market, and I feel that the bond picture is particularly interesting at this time. The accompanying chart traces the action of three important bond indices from 1960 to the present (see chart above).

Normally, a forthcoming expansion in business means increasing money rates, diminishing investment interest in bonds, and accordingly -- lower bond prices. The speculative or 2nd grade rail bonds are frequent exceptions to this rule, however, and these high-yielding bonds are more apt to fluctuate with the changing fortunes of the rail industry (i.e., a brightening rail picture will send speculative rail bonds higher).

To review the bond picture, Barron's Treasury Bond Index struck a high of 92.08 in August, 1960 (see chart). Following a decline, this Index formed a perfect "double top" in May, 1961 (92.00), and this second top corresponded with the improving business picture which brightened the latter half of 1961. During most of 1962 the Treasury Index climbed higher, and in November this Index recorded a third peak of 91.33. Since then the Treasuries have gone into a mild decline. Interestingly enough, however, despite the market rise and the expansion of business, the Treasury Index is not now acting in the same manner as it did during previous periods of economic expansion. As the head of a bond house recently told me: "It is as if the Treasury Bond buyers don't believe in the coming boom."

The broad D-J Bond Average is acting particularly well, having recently reached a high point for the past five years. Furthermore, one of the components of the 40-Bond Average, the D-J 2nd-Grade Rail Bond Average (see chart), has made a spectacular recovery, and during the month of April, 1963, this index actually rose in price above the price of the 40-Bond Average. It is interesting to note that the 2nd-Grade Rail Bond Average hit bottom in late 1961, continued to rise during all of 1962 (while the stock market was sagging), then rose even more steeply during late 1962 and early 1963.

Lastly, Barron's Confidence Index is now deserving of comment. This Index consists of the ratio of the yield of Barron's 10 Highest-Grade Bond Average to the yield on the broad D-J 40-Bond Average. Thus, if bond money moves into the more speculative 40-Bonds (with their higher yields), this action represents an expansion in Confidence (and the Confidence Index accordingly rises). Conversely, if bond money grows pessimistic, it will move towards higher grade debt (while accepting lower yields). At such times, the Confidence Index will decline.

Currently, the Confidence Index is at its highest level in many years, following a rising trend which began in mid-1962. One of the greatest factors in this rise has been the surge of the most volatile component of the D-J 40-Bond Average, the 2nd-Grade Rail Average.

From this study, it can be seen that the earliest technical indication of a coming rise in investor confidence was the giant rise in rail bonds, an advance which began in late 1961 and continued all through the 1962 stock market collapse.

Consciously or unconsciously, it is apparent that rail bond buyers anticipated the turn for the better in the carrier industry six months to a year before stock buyers did. Consequently, this writer plans to take particular notice of the first sign of an important decline in the 2nd-Grade Rail Index, and such information will immediately be called to the attention of subscribers.

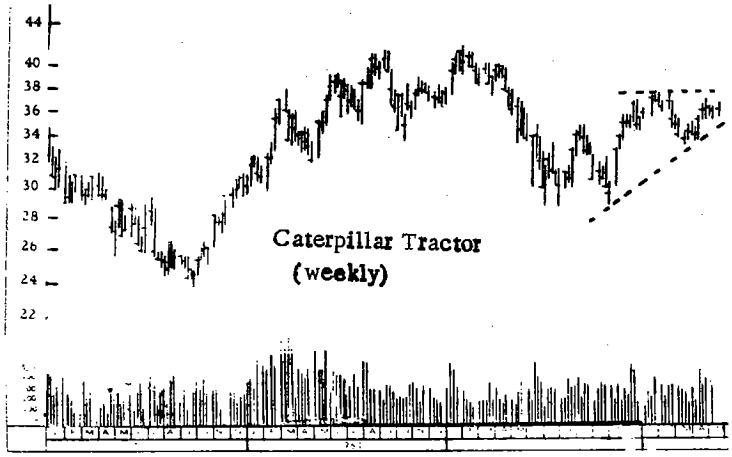
STOCKS Of 350 stocks tabulated each week at this office, 252 or 72% are now holding above their 30-week moving average (no percentage change from last week).

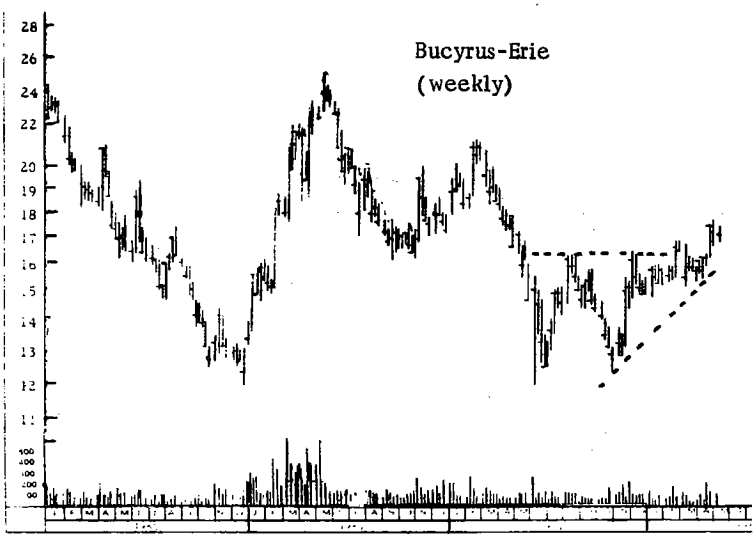
The "work" on this advance continues to be done by a limited number of stocks, and to this extent it has been a frustrating move. I have been reviewing recent "buy" suggestions from these Letters, and I note that some of them have moved out well, while others (mainly secondary issues) are in many cases, just beginning to show signs of "life" (i.e., Kaiser Alum., Allis Chalmers, Cerro).

Kaiser Industries is a low-priced (American Exchange) stock with plenty of stock and debt outstanding. It is an extremely volatile issue, and the daily chart is shown below. KI has been holding to an ascending trendline, and volume has been tending to expand as the stock works higher.

Caterpillar Tractor and Bucyrus-Erie are both "heavy industry" stocks which are showing signs of moving out (weekly chart shown below). Both of these issues should be good vehicles to participate in an extension of the current rise.

A number of subscribers have written asking for a "speculative package", with which they could frankly participate in any potential "blow-off" in the market. The following package would be my choice: Kaiser Industries and Tri-Continental Warrants on the American Exchange (TY Warrants were discussed in detail in Letter 214), J. I. Case (discussed in Letter 210), Bucyrus-Erie (today's Letter) and Allis Chalmers (Letter 217). From experience, I do not like buying a single stock for speculative purposes. However, if a package is purchased (even odd-lot amounts), and one stock in that package really performs, the whole project becomes worthwhile.





Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri.